



FINANCIAL MARKETS & BANKING UPDATE VOL. 2: FY2025-FY2026

Bank credit growth picks up pace with borrowers shifting to banks from bond market in Q2 FY2026; trend remains monitorable in H2 FY2026

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Abbreviations

AUM: Assets under management	FY: Financial year	NBFC: Non-banking financial company
BSNL: Bharat Sanchar Nigam Limited	G-Sec: Government securities	NSDL: National Securities Depository Limited
CASA: Current account and savings account	GDP: Gross domestic product	NSO: National Statistical Office
CAD: Current account deficit	GFCE: Government final consumption expenditure	OMO: Open Market Operations
CD: Certificates of deposit	GFCF: Gross fixed capital consumption	PFCE: Private final consumption expenditure
CDSL: Central Depository Services (India) Limited	Gol: Government of India	PSB: Public sector bank
CEA: Central Electricity Authority	GST: Goods and Services Tax	PVB: Private sector bank
CIC: Currency in circulation	GVA: Gross value added	QoQ: Quarter on quarter
CP: Commercial paper	HFC: Housing finance company	RBI: Reserve Bank of India
CPI: Consumer Price Index	IDBI: IDBI Bank Limited	RDB: Rupee denominated borrowings
CMB: Cash management bills	IIP: Index of Industrial Production	SIAM: Society of Indian Automobile Manufacturers
CRR: Cash reserve ratio	IPO: Initial public offer	SIDBI: Small Industries Development Bank of India
CWP: Currency with public	IMD: India Meteorological Department	SCB: Scheduled commercial bank
CY: Calendar year	INR: Indian rupee	SDL: State development loans
DII: Domestic institutional investors	JV: Joint venture	SLR: Statutory liquidity ratio
DIPP: Department of Industrial Policy and Promotion	LAF: Liquidity Adjustment Facility	TLTRO: Targeted long-term repo operations
ECBs: External commercial borrowings	LIBOR: London Interbank Offered Rate	T-Bill: Treasury bill
EM: Emerging markets	LPA: Long period average	TTM: Trailing 12 months
FAR: Fully Accessible Route	LRS: Remittance Scheme	UAE: United Arab Emirates
FCCBs: Foreign currency convertible bonds	LTRO: Long-term repo operations	\$: United States dollar
FCI: Food Corporation of India	MGNREGA: Mahatma Gandhi National Rural Employment Guarantee Act	VRR: Variable Rate Repo
FDI: Foreign direct investment	MPC: Monetary Policy Committee	VRRR: Variable Rate Reverse Repo
FII: Foreign institutional investment	MSCI: Morgan Stanley Capital International	WoS: Wholly-owned subsidiary
FPI: Foreign portfolio investment	MSF: Marginal Standing Facility	WPI: Wholesale Price Index
FPO: Follow-on public offer	NABARD: National Bank for Agriculture & Rural Development	WACR: Weighted average call rates
FSB: Fully serviced bonds	NDTL: Net demand & time liabilities	YTD: Year to date

1 Foreign Investment and External Commercial Borrowings



2 Growth



3 Inflation



4 Deposit and Credit



5 Money Supply, Liquidity, and Yields



6 Annexures





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The 10-year G-Sec yield is likely to trade at 6.45-6.55% in the remainder of FY2026.

FPIs turned net sellers in Q2 FY2026, withdrawing \$4.5 billion from India; while the equity segment saw sizeable outflows amounting to \$8.7 billion, FPIs invested \$4.2 billion in the debt segment.

- **India's yield curve steepens further at the end of Sep 2025:** The 10-year G-Sec yields hardened in August and September 2025, rising to 6.57% as on September 30, 2025 (from 6.32% on June 30, 2025), however, was similar to the yield as on March 31, 2025 at 6.58%. The hardening was largely driven by concerns on US tariffs, and the reversion of stance by the RBI to 'neutral' from 'accommodative', dampening the market expectations of further rate cuts. In addition, expectation of potential increase in borrowings by GOI because of GST rate cuts fueled the increase in yields. The 91-day T-Bill continued to be at similar levels in Q2 FY2026 as were seen in June 2025; though closed marginally higher at 5.47% as on September 30, 2025 compared to 5.41% as on June 30, 2025 (lower than 5.63% as on May 31, 2025, 5.93% as on April 30, 2025, 6.37% as on March 31, 2025). Given the impact of the GST rationalisation and an elevated base (+6.2% in October 2024), the headline CPI inflation is likely to soften further in October 2025. ICRA believes that a final 25-basis points (bps) rate cut is possible in the December 2025 policy meeting, with its timing contingent on growth-inflation outcomes. Looking ahead, we foresee the 10-year G-sec yield (6.33 GS 2035) to remain in the range of 6.45-6.55%.
- **Bond issuances moderated in Q2 FY2026:** Bond issuances moderated to Rs. 2.7 trillion in Q2 FY2026 from Rs. 3.6 trillion Q1 FY2026 (Rs. 3.0 trillion in Q2 FY2025) but remained reasonably high. The sharp fall in bond yields amid the slow pass-through of rate cuts to banks' lending rates led to higher bond issuances in Q1 FY2026. The bond yields increased in Q2 FY2026, leading to shift of credit demand to banks from bonds. Of the total issuance in Q2 FY2026, the share of NBFC, corporates and banks (including All India Financial Institutions; AIFIs) stood at 31%, 62% and 7%, respectively compared to 44%, 24% and 32% respectively in Q2 FY2025. Looking ahead, bond issuances are expected to be driven by NBFCs given the banks' cautious approach towards funding them and with the yields remaining attractive vis a vis bank loans. Thus, ICRA has revised its estimate of bonds issuance in FY2026 at Rs. 12.0-12.4 trillion from earlier estimate of Rs. 11.1-11.7 trillion.
- **FPIs withdrew \$4.5 billion from Indian markets in Q2 FY2026, led by equity segment:** India witnessed net FPI outflows (equity, debt and hybrid) of \$4.5 billion in Q2 FY2026, after muted inflows of \$0.4 billion in Q1 FY2026. FPIs sold a staggering \$8.7 billion from the equity market in Q2 FY2026, as India's macroeconomic outlook weakened after the imposition of US tariffs and penalties, leading to the slide in the USD/INR pair. In contrast, the debt segment saw inflows of \$4.2 billion in the quarter, reversing the trend of net outflows in the prior three quarter (-\$4.1 billion), partly supported by higher yields, as well as the increased possibility of additional rate cut(s) in India.

Net FDI inflows increased to \$5.7 billion in Q1 FY2026 after turning positive at \$0.7 billion in Q4 FY2025.

LRS remittances trended flat at \$6.9 billion in Q1 FY2026 compared to Q1 FY2025; while 2M Q2 FY2026 clocked lower than corresponding period last year.

Gross ECB approvals moderated in 5M FY2026 compared to corresponding period last year.

India's GDP growth is expected to ease to 6.0-6.5% in Q2 FY2026 from 7.8% in Q1; it is expected to print at 6.5% in FY2026, in line with the growth seen in FY2025.

- **Net FDI inflows (including reinvested earnings) on recovery trajectory:** Net FDI inflows declined sharply over the past few fiscals led by the trend of record high repatriations from India. However, a reversal in the quarterly trend was observed with Q4 FY2025 closing with net inflows of \$0.7 billion and supported by the increase in the net FDI inflows of \$5.7 billion in Q1 FY2026. Excluding the effect of reinvested earnings, the net FDI flows closed at an inflow of \$3.7 billion in 5M FY2026 compared to the outflow of \$1.4 billion in 5M FY2025. With the persisting uncertainties with respect to the US tariffs, the trend of further investments remain monitorable, which may affect the net FDI flows to India.
- **LRS outflows in FY2026 to likely normalise around FY2025-level** Total outflows under LRS totalled \$6.9 billion in Q1 FY2026 trending flat compared to Q1 FY2025. Further in Q2 FY2026 (till August 2025) the LRS remittances clocked \$5.1 billion compared to the \$5.9 billion in corresponding period last year. Higher tax incidence impacted the outflows in H2 FY2025 and the trend in current year is expected to remain range bound to FY2025-tally.
- **ECB approvals in FY2026 to remain below FY2025 level:** Gross ECB approvals moderated to \$15.7 billion in 5M FY2026 from \$20.6 billion in corresponding period last year (net of refinancing, \$12.7 billion in 5M FY2026 compared to \$18.2 billion corresponding period last year). With the favourable yields in the domestic markets, the pace of ECB approval and issuances is likely to dip in FY2026. Accordingly, ICRA maintains its estimate for the gross ECB approvals at \$50-55 billion in FY2026, lower than record high \$61.2 billion in FY2025.
- **India's GDP growth to slow down in Q2 FY2026:** While the early monsoon onset and abundant rains aided kharif sowing, agri-GVA growth in Q2 FY2026 is likely to be constrained by the adverse base. Further, the impact of excess rainfall and flooding on crop output remains monitorable. Additionally, the growth in industrial volumes doubled during July-August FY2026 over Q1, partly owing to the low base, even as the performance of service sector indicators remained mixed during this period. The trends for investment activity were muted in Q2 FY2026, amid continued tariff-related uncertainty. ICRA expects the GDP growth to decelerate to 6.0-6.5% in Q2 FY2026 from the elevated 7.8% in Q1 FY2026. Looking ahead, the outlook for H2 FY2026 is decidedly mixed, with the positive impact of the GST rejig on private consumption partly offsetting the tariff-related pain. Besides, the GoI's capital expenditure (capex) is set to moderate during the rest of the fiscal, after frontloading in 5M FY2026, which would weigh upon GDP growth in H2 FY2026. Moreover, the impact of evolving policy changes around H-1B visas and the Halting International Relocation of Employment (HIRE) Act further pose a key downside risk. Overall, ICRA estimates the GDP to grow by 6.5% in FY2026 (+6.5% in FY2025 PE).

CPI inflation receded significantly to a series-low of 1.7% in Q2 FY2026, owing to softening in food prices.

ICRA believes that a final 25-bps rate cut is possible in the December 2025 policy meeting, contingent on growth inflation outcomes.

Liquidity conditions remained comfortable in Q2 FY2026, despite the temporary moderation in September 2025, amid advance tax outflows.

The remaining CRR cut of 50 bps in November 2025 is likely to ease pressure on liquidity owing to seasonal currency leakage in Q3.

- **CPI inflation cooled to 1.7% in Q2 FY2026, the lowest in the current series:** The headline CPI inflation moderated for the third consecutive quarter in Q2 FY2026 to a series-low of 1.7% from 2.7% in Q1 FY2026. The softening was mainly attributed to the food and beverage (F&B) segment, which slipped into a YoY deflation of 0.7% in Q2 FY2026 (+1.1% in Q1 FY2026) after a gap of 25 quarters. This was followed by modest dips in inflation for the clothing and footwear, miscellaneous, and fuel and light segments, even as housing, and pan, tobacco and intoxicants reported an uptick in Q2. Looking forward, the rationalisation of GST rates is expected to pull down CPI inflation to the sub-1.0% mark in October 2025, also supported by the high base. Overall, ICRA foresees a downside to the FY2026 CPI inflation forecast of 2.6%.
- **Final 25-bps rate cut likely in December 2025:** ICRA believes that a potential rate cut is going to be slightly more contingent on the outcomes and outlook for growth rather than inflation, given that the downward revision in the latter by the MPC was mainly influenced by GST rate cuts along with the upbeat outlook on crop output/supply, and not weak demand. The actual degree of consumption push and its impact on GDP growth needs to be monitored, as the Committee noted that current growth remains below the potential rate. Given the dovish tone of the October 2025 policy document, ICRA believes that a final 25-bps rate cut is possible in December 2025, contingent on the degree of further transmission of the cumulative 100-bps rate cuts to the credit market as well as growth implications of the GST rejig and tariffs.
- **Liquidity pressure from seasonal currency leakage, capital outflows in Q3 to be partly offset by CRR cuts:** The average systemic liquidity surplus rose to Rs. 2.5 trillion (+1.0% of NDTL) in Q2 FY2026 from Rs. 2.0 trillion in Q1 FY2026 (+0.8% of NDTL), aided by the liquidity infusion measures undertaken by the RBI. Notably, liquidity had temporarily turned into an average deficit of Rs. 280 billion during September 20-24, although this was seasonal in nature owing to advance tax and GST outflows, before it reverted to a surplus thereafter. The durable liquidity surplus stood at an elevated Rs. 5.2 trillion or 2.2% of NDTL as on September 19, 2025. Going forward, the remaining CRR reduction of 50 bps in November 2025 (injecting Rs. 1.3 trillion) is likely to support liquidity conditions, partly offsetting the pressure of higher demand for cash seen during the festive season while also supporting monetary transmission. Additionally, the redemption of G-Secs worth Rs. 982 billion on November 9, 2025 would augur well for systemic liquidity.

YoY deposit growth is estimated at 10.5-11.3% in FY2026. Incremental deposits are projected at Rs. 23.8-25.5 trillion for FY2026.

Incremental credit expansion is projected at Rs. 19.0-20.5 trillion for FY2026, translating to a YoY growth of 10.4-11.3%.

- **Deposit growth remained steady in Q2 FY2026*:** The deposit accretion remained healthy at Rs. 6.7 trillion in Q2 FY2026* (Rs. 8.5 trillion in Q1 FY2026*, Rs. 6.3 trillion in Q2 FY2025*), though the same trailed the deposit accretion in Q1 FY2026. The deposits outstanding of the banking system rose to Rs. 241.0 trillion (+9.9% YoY growth) as on October 3, 2025 from Rs. 219.2 trillion as on October 4, 2024 (+11.8% YoY growth). CD outstanding stood at Rs. 5.0 trillion as on October 03, 2025 (Rs. 5.1 trillion as on June 27, 2025, Rs. 5.3 trillion as on March 21, 2025, Rs. 4.7 trillion as on October 04, 2024). Amid surplus liquidity in the system in Q2 FY2026, the CD levels remained similar to the elevated levels as seen in the past couple of months, driven by finer rates prevailing in the market for bulk deposits compared to retail deposits. While the CDs outstanding as a percentage of total deposits declined to 2.1% as on October 3, 2025 from 2.4% as on March 21, 2025, it stood same as 2.1% as on October 4, 2024. ICRA expects deposit accretion at Rs. 23.8-25.5 trillion (10.5-11.3% growth) for FY2026 while outstanding deposit is estimated at Rs. 249.6-251.3 trillion by March 2026.
- **Credit accretion picked up sharply in Q2 FY2026:** incremental non-food bank credit (NFBC) expansion picked up sharply in Q2 FY2026 (till October 3, 2025) at Rs. 8.0 trillion after remaining tepid at Rs. 2.1 trillion in Q1 FY2026. this can be attributed to banks becoming competitive compared to the bond markets as the yields in the bond market increased, while bank rates for fresh lending continued to decline in Q2 FY2026. The likely increase in economic activity post the GST cut on September 22, 2025, could have spurred the demand for channel financing as well as retail loans leading to one of the highest ever increase in fortnightly credit flow. Consequently, the incremental credit growth in H1 FY2026 stood healthy at Rs. 10.2 trillion compared to Rs. 8.7 trillion in H1 FY2025 (Rs. 18.0 trillion in FY2025). With the upcoming cash reserve ratio (CRR) cut (one tranche already done) and the full impact of GST rationalisation, ICRA expects credit growth to pick-up in H2 FY2026. Additionally, the easing of the credit-to-deposit (CD) ratio and abundant liquidity in the banking system shall be supporting factors for the credit growth. However, persistent uncertainties around tariffs and emerging concerns over asset quality are likely to keep the sector cautious. Consequently, ICRA maintains its credit growth projections for the banking sector at Rs. 19.0–20.5 trillion for FY2026, reflecting a YoY growth of 10.4–11.3%.

Note: Data for Q2 FY2026 is from June 27, 2025 to October 3, 2025, data for Q1 FY2025 is from March 21, 2025 to June 27, 2025; data for Q2 FY2025 is from June 28, 2024 to October 4, 2024*



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